

Lottery or calcutta wagering pool operated by social club. The wagering and occupational taxes imposed by sections 4401 and 4411 of the Code do not apply to activities of a nonprofit social club, exempt from income tax under section 501, involving the conduct of (1) a lottery in which participation is limited to members only and the net proceeds are used to defray operating expenses or to offset losses incurred in the club's activities which are devoted exclusively to the pleasure and recreation of members, or (2) a calcutta wagering pool in connection with a golf tournament for the pleasure and recreation of members and their guests, the proceeds from which are used primarily to pay the winners of the pool, with a portion retained by the club to defray operating expenses.

Advice has been requested concerning the applicability of the taxes imposed by sections 4401 and 4411 of the Internal Revenue Code of 1954 to certain wagering activities conducted by the organizations in the situations described below.

Situation 1. A social club, as part of its regular activities, conducts a lottery consisting of a drawing to which tickets are sold. The purchase of tickets and participation in the drawing are limited to club members only. A portion of the proceeds from the sale of tickets is used to pay the winners of the drawing. The remaining proceeds become a part of the general funds of the club and are used to defray its operating expenses or to offset losses incurred in the club's activities, which are devoted exclusively to the pleasure and recreation of its members. The lottery constitutes a major source of revenue for the club. The club has been recognized as exempt from income tax under section 501(a) of the Code as a nonprofit organization described in section 501(c)(7).

Situation 2. A social club holds an annual golf tournament for its members and in connection with these events the club operates a 'calcutta' wagering pool. Participation in the calcutta is limited to club members and their guests. Proceeds from the sale of tickets to the calcutta are used primarily to pay the winners of the pool. The remaining proceeds from the pool are retained by the club and used to defray expenses of the club. The club is thereby able to meet operating expenses without increasing dues or levying additional assessments on its individual members. All the club's activities are devoted to furthering the pleasure and recreation of its members. The club has been recognized as exempt from income tax under section 501(a) of the Code as a nonprofit organization described in section 501(c)(7). The 'guests' who participate in the wagering pool are persons who would qualify as guests of members under the standards of section 501(c)(7) and 512(a)(3).

Section 4401(a) of the Code imposes an excise tax on wagers, as defined in section 4421. Section 4401(c) provides that each

person who is engaged in the business of accepting wagers shall be liable for and shall pay the tax on all wagers placed with him. That section further provides that each person who conducts any wagering pool or lottery shall be liable for and shall pay the tax on all wagers placed in such pool or lottery. Section 4411 imposes a special tax of \$50 per year to be paid by each person who is liable for the tax under section 4401 or who is engaged in receiving wagers for or on behalf of any person so liable.

The term 'wager' is defined in section 4421(1) of the Code to include:

- (A) any wager with respect to a sports event or contest placed with a person engaged in the business of accepting such wagers,
- (B) any wager placed in a wagering pool with respect to a sports event or a contest, if the pool is conducted for profit, and
- (C) any wager placed in a lottery conducted for profit.

Section 4421(2)(B) excludes from the term 'lottery' any drawing conducted by an organization exempt from income tax under section 501 if no part of the net proceeds derived from such drawing inures to the benefit of any private shareholder or individual.

The report of the House Ways and Means Committee to accompany the Revenue Act of 1951, establishing the tax on wagers, provides that wagers on sports events or contests are taxable if the wager is placed with a person engaged in the business of accepting such wagers. The Report further states that the purpose of this requirement is to exclude from tax the purely 'social' or 'friendly' type of bet. See H.R. Rep. No. 586, 82nd Cong., 1st Sess. 55-56 (1951), 1951-2 C.B. 357, 397.

Where a nonprofit social club, exempt from income tax under section 501 of the Code, conducts a lottery in the form of a drawing in which participation is limited to members, and any net profits derived from the drawings are applied in furtherance of the general purposes for which the organization is entitled to exemption under section 501, no profit is considered to inure to the individual members or other private shareholders. Under such circumstances, the fact the club's net earnings are raised through profitable club activities rather than dues is irrelevant, inasmuch as the members continue to bear all costs of the club's operations in the same way they do when paying dues. Thus, the drawing would come within the exclusion from the tax on lotteries provided by section 4421(2)(B). See *Rochester Liederkrantz, Inc. v. United States*, 456 F.2d 152 (2nd Cir. 1972).

Where a nonprofit social club, exempt from income tax under section 501 of the Code, conducts a calcutta or other wagering pool for the pleasure and recreation of its members and their guests only, the calcutta is not considered to be operated for profit even though the club retains some part of the proceeds from the calcutta to defray operating expenses and even though, as a result of retaining the proceeds, the club does not increase dues or levy other assessments on the members. Under such circumstances, the calcutta or other wagering pool conducted by the club does not constitute the acceptance of wagers placed with one engaged in the business of accepting wagers, and the calcutta is not a wagering pool conducted for profit within the meaning of section 4421(1). See *Augusta Golf Association, Inc. v. United States*, 338 F.Supp. 272 (S.D. Ga. 1971).

In situation 1, above, the drawing conducted by the social club is limited to members only and the net proceeds from the drawing are used solely to meet the club's operating expenses. In addition, the operation of the drawing is in furtherance of the club's recreational purposes. Accordingly, no part of the net proceeds from the drawing is considered to inure to the benefit of any private shareholder or individual and such drawing comes within the exclusion from the wagering tax on lotteries provided by section 4421(2)(B) of the Code. Therefore, the club is not liable for the taxes imposed by sections 4401 and 4411. The fact that a major portion of the club's revenue is derived from the drawing activity is immaterial under these circumstances. See Rev. Rul. 69-68, 1969-1 C.B. 153, which, for purposes of the exemption from income tax under section 501, concludes that the fact a club derives a principal part of its revenue from its recreational facilities does not affect its exempt status, so long as the facilities are used only by members and their guests.

In situation 2, the calcutta is conducted for the pleasure and recreation of the club's members and their guests and in furtherance of the club's exempt purposes. Furthermore, the remaining proceeds from the calcutta or wagering pool are retained and used by the club solely for the purpose of defraying the other expenses of the club. Therefore, the club is not engaged in the business of accepting wagers or conducting a wagering pool for profit within the meaning of section 4421(1) of the Code and is not liable for the taxes imposed by sections 4401 and 4411.

Compare Rev. Rul. 56-72, 1956-1 C.B. 532, which holds that the taxes on wagering apply to the operation of a calcutta or similar wagering pool by a hotel corporation in connection with a golf tournament it sponsors, where a portion of the receipts from the pool are retained by the hotel for use in promoting the next year's tournament. That Revenue Ruling further concludes that, notwithstanding the above, even if the hotel did not retain any of the wagering pool's proceeds, the increased patronage to its other facilities as a result of the calcutta is considered an

indirect benefit sufficient to constitute profit for purposes of the wagering tax.